Chapter 4 Risk Assessment

Chapter 4, Section 1

About this chapter

4.1.1 Purpose of this chapter

What is risk?

Risk is an aspect of everyday life. Agencies evaluate and manage risk regularly when making budgetary decisions, hiring, and setting work priorities. Contracting for goods and services is no exception. The ultimate goal of competitive contracting is to deliver the best value for the public's dollar via a process that is fair and objective to all of those involved or affected.

Risk falls into two general categories:

Inherent - Resulting from the very nature of the service's objectives and scope; or

Acquired - Resulting from selected approaches, methods, techniques, and the relative skill set of those delivering the service.

Although the title of this chapter is Risk Assessment, its purpose goes beyond the mechanics of simply assessing risk. This chapter illustrates agencies' considerations and introduces methods, and techniques to identify, evaluate, mitigate, communicate, and manage inherent and acquired risks associated with the competitive contracting process.

There exist many sources of information and methods for risk management (see 4.7 for a list of additional resources). This chapter will not attempt to cover every possible method or technique but instead will act as the starting point for agencies in determining their approach towards risk within the competitive contracting context.

Note: ***Agencies shall use the Information Services Board (ISB) IT Investment Standards (Appendix A - Severity & Risk Level Criteria and Oversight)*** ***http://dis.wa.gov/portfolio/101S.htm#appendixA***

4.1.2 Key components of this chapter

Managing risks is an important part of the competitive contracting process

> RCW 41.06.142 (e) states, ". . . The contracting agency must consider the consequences and potential mitigation of improper or failed performance by the contractor."

Managing risk is not a one-time event. It involves an on-going effort that is highly integrated not only at each decision point, but also as part of any on-going contract management and monitoring plan. It can be applied to individual situations or across the entire scope of a competitive contracting project.

This chapter is divided into the following sections:

- **Establish the Context** - Organizational goals, objectives, strategies, and stakeholders and how the competitive contracting proposition fits within this context
- **Identify the Risks** - Identifying and categorizing risks
- **Evaluate and Prioritize Risks** - Methods and approaches: rating, analysis, and prioritizing

- **Treat the Risks** - Mitigating the impact of risks
- **Risk Management Plan** - Controls and plan creation
- **Monitor and Control/Review** - Communicating the plan and incorporaing it into the contract/performance agreement
- **Additional resources** - Links to other sources for managing operational risk

Chapter 4, Section 2

Establish the context

4.2.1 Identify the agency's operational environment

A risk assessment begins with the agency identifying its operational environment

To establish potential sources of risk, the agency must first develop the context. Recall from section 1.1.1 of this manual when we introduced the likely drivers for an agency to consider competitive contracting? They are:

1. The agency has applied re-engineering and continuous improvement to the service but has not been able to deliver required levels of performance commensurate with the agency's investment of resources and funding.
2. The agency's need to acquire access to skills, competencies, expertise, and innovative technologies that the agency itself cannot sustain.
3. The need to leverage capacities and economies of scale, which are not available within the agency, but are available from suppliers who are capitalized and specialized in providing the same service to others.
4. Re-allocation and redeployment of the agency's limited resources towards focused mission related services that support the state's priorities of government.
5. Direction from the Governor or Legislature.

Each of these driving factors stems from the operational environment facing the agency at a specific point in time.

When considering risk, the natural starting point for agencies is with the strategic plan that each agency is required to create and submit during the budget process. All of the elements required to determine the operational context are included in the strategic plan.

Note: ***OFM's 05-07 Biennium Budget Instructions describe the strategic plan requirements in detail, see:***
http://www.ofm.wa.gov/budget/instructions/05-07budinstpart1.pdf

The operational environment is made up of both internal and external components:

Internal environment

- Are the overall goals, objectives, strategies, and activities of the agency still aligned with the Priorities of Government?

- How effective have existing strategies been in meeting the agency's goals and objectives?
- How effective have services been in supporting the agency's strategies?

External environment

- Are there changes in the authorizing environment?
- What are the competitive pressures affecting the agency?
- What is the economy doing?
- What is the demand outlook for specific service(s)? (For example; are they up, down, or volatile?)

The next section will describe how a listing of the agency's internal and external operating environments can be used to identify the agency's strengths, weaknesses, opportunities, and threats. This becomes an important part of determining the overall risk facing the agency.

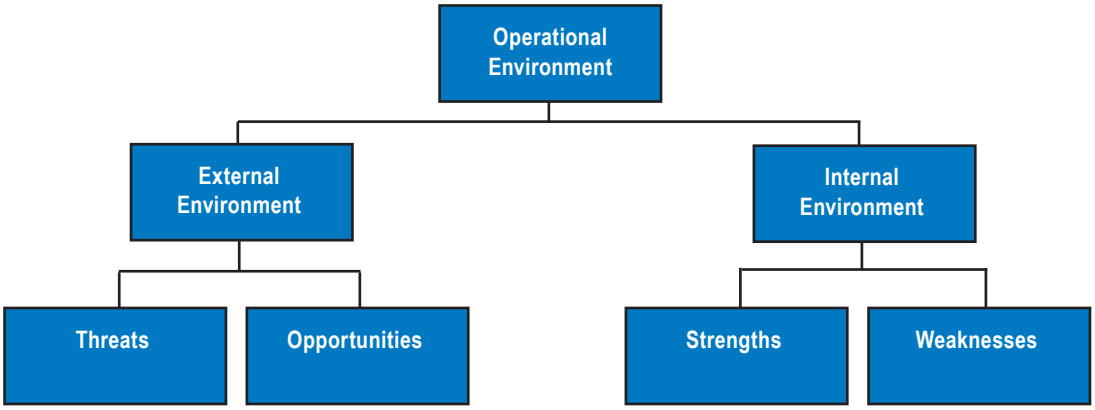
4.2.2 Identify strengths, weaknesses, opportunities and threats

SWOT Analysis

A standard method for analyzing strengths, weaknesses, opportunities, and threats is the SWOT technique. However, before the agency can use SWOT Analysis, they need to determine their operational environment as described in the previous section. SWOT Analysis helps the agency assess risk by considering their current situation relative to stated strategies, goals, and objectives. Consider *Figure 17*:

Figure 17

SWOT Analysis Model



Once the operational environment has been identified, the agency aligns strengths, weaknesses, threats, and opportunities as illustrated in Figure 17. To help illustrate this concept consider these examples. As shown in the Figure 17, strengths and weaknesses relate to the agency's internal environment. First, consider an example of a weakness:

Example: An agency has always struggled with pegging demand for a specific service. A year ago it invested $2M in additional capital infrastructure to support a forecasted increase in demand. Only half of that demand materialized and thus the agency has failed to realize its return on the $2M investment. The weakness of the agency, in this example, is its inability to accurately forecast demand. Consequently, any future decisions based on its ability to forecast demand will be deemed risky and therefore will be met with less confidence and greater skepticism.

Other examples of weaknesses:

- Poor customer service
- Lack of necessary skill sets among employees and managers
- High turnover
- Outmoded systems and technologies

Next consider an example of a strength:

Example: The same agency has a very sound and solid track record in managing its suppliers and contractors. It has developed a sound contract monitoring process to measure contract performance, costs, service delivery quality, and other contract standards. It has incorporated this process into policy by requiring a quarterly review of the agency's major suppliers and corrective action plans for non-conformance.

Other examples of strengths:

- Standardized processes and methods
- Excellent internal communication
- Sound strategic planning and review cycle
- Highly evolved and effective performance measurements

Along with its strengths and weaknesses, the agency determines opportunities and threats. Opportunities and threats relate to the agency's external environment. Expanding on this scenario, here is an example of a threat:

Example: The agency's inability to accurately forecast demand has led to pressure from the Legislature and citizen's groups to consider private providers which are being used successfully by other states to deliver this same service.

Other examples of threats:

- Looming economic downturn and subsequent funding crunch
- Effective and determined lobbying to agency customers by the competition
- A tight labor market shrinks the availability of qualified employees

Finally, consider the example of an opportunity:

Example: The State of Montana contracted with a private provider to deliver the service in question three years ago. In Montana's case, the contractor provided a turnkey solution by acquiring the entire capital infrastructure from the state and hiring the displaced state employees.

Other examples of opportunities:

- Concerted effort by employees and managers of another agency has resulted in a breakthrough method of delivering a service in an efficient and innovative way while saving $3M annually
- A new and emerging technology is becoming available that could substantially improve productivity

4.2.3 Identify relevant stakeholders

Stakeholders must be identified

Included in any discussion of risk in the competitive contracting process are the stakeholders to whom any decision or award would have an impact. Consider the example provided in *Figure 18*. The example illustrates a receiving function being performed by the central warehouse of a large institution. The stakeholders are identified throughout the value chain, starting with suppliers and providers that are delivering products to the customer who receives their order. By mapping the value chain, agencies will create a comprehensive profile of everyone that can be affected by the decision to competitively contract. In addition to helping identify potential threats, opportunities, strengths, and weaknesses around a particular course of action, the identification of all the stakeholders will facilitate project management and communication planning.

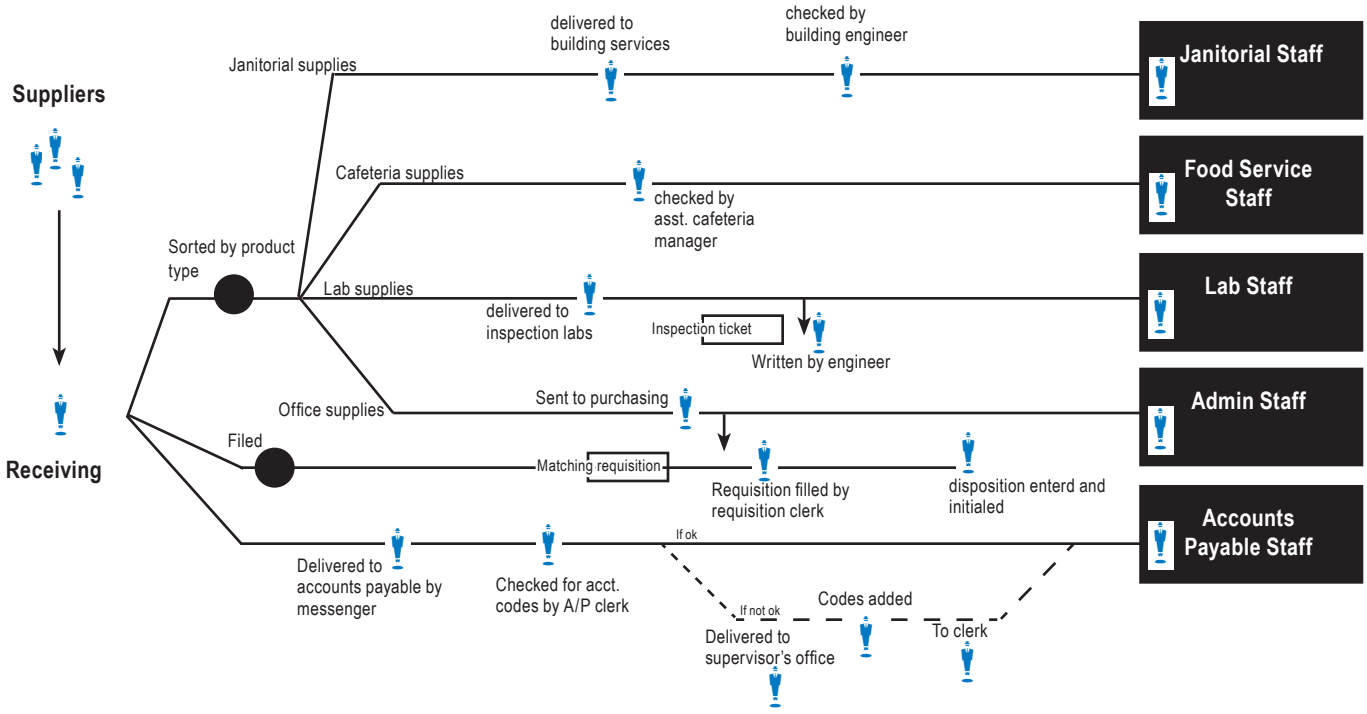
In the context of competitive contracting within the State of Washington who might be considered stakeholders?

- State employees
- Employee organizations
- Other agencies
- Citizens
- Lawmakers
- Local communities
- Suppliers
- Anyone who could be impacted by the decision to competitively contract

Figure 18

The Value Chain

The Value Chain - Receiving, Central Warehouse Services - Hospital Example



4.2.4 Establish a risk criteria

Harvesting the results of the SWOT Analysis and stakeholder work

Once the agency has completed its Strengths Weaknesses Opportunities and Threats (SWOT) Analysis, it can begin to determine its risk criteria. Fundamentally, the outcome of establishing risk criteria is to determine what level of risk (or risk threshold) the agency is prepared to assume and which person within the agency has the authority to decide to accept different levels of risk. This risk threshold will act as a show-stopper to the competitive contracting process until such time as a risk mitigation plan is developed or the risk is removed entirely. The risk threshold applies regardless of any potential savings or efficiency improvements that may result from awarding a contract. This risk threshold is also dynamic, and agencies will need to monitor and manage it throughout the project and beyond as part of ongoing contract administration.

Let's expand on the example from 4.2.2.

Example: All stakeholder input into the SWOT Model has been received. The agency has also reviewed its strategies goals and objectives against its assumptions around the decision to competitively contract.

Strength -Opportunity Criteria - Least risk; the opportunity plays to the strength of agency. This level of risk can be addressed by the project team.

Weakness -Opportunity Criteria - Agency's weaknesses create risk in realizing the opportunity. The project team would escalate this to an appropriate management level with its recommendations.

Strength - Threat Criteria - Least risk; the agency applies its strengths to address the threat. This level of risk can be addressed by the project team.

Weakness - Threat Criteria - Greatest risk; the agency's weaknesses are not adequate to address the threat. The project team would escalate this to an appropriate management level with its recommendations.

Now let's apply an example to a matrix:

Example: This is one approach that can be used to prioritize risk analysis and treatment. *Figure 19* illustrates the risk criteria discussed here and in the previous example.

Risk: If the decision is to award to a contractor, they may go out of business (Business Continuity).

Criteria: S-O. The plan to minimize and manage this risk is developed by the project team as a project deliverable.

Why:

- Based on our available opportunities there are a number of players in the market that provide the same service;
- Employees and managers have new methods and technologies available (may not result in award to a contractor);
- The agency's strength in standardization and documentation allows for contingencies like in-sourcing and switching to an alternate supplier; and
- The agency's strength in contract management and monitoring will proactively identify this possibility.

SWOT Matrix

		Strengths	Weaknesses
		1. Standardized processes and methods 2. Excellent internal communication 3. Sound strategic planning and review cycle 4. Highly evolved and effective performance measurements 5. Sound contact management monitoring process	1. Poor customer service 2. Lack of necessary skill sets among employees & managers 3. High turnover 4. Outmoded systems and technologies 5. Poor demand in forcasting
Opportunities	1. Turnkey supplier solution 2. Breakthrough method by employees and managers 3. New & emerging technology to improve productivity	S - O	W - O
Threats	1. Looming economic downturn and subsequent funding crunch 2. Effective and determined lobbying to your customers by other providers 3. Economic upswing drives up the market for qualified employees 4. Pressure from Legislature & Citizens groups to consider private providers	S - T	W - T

Risk →

Figure 19

SWOT Matrix

Chapter 4, Section 3

Identifying risks

4.3.1 Why is risk identification so important?

Failure of the agency to identify all possible risks may have disastrous consequences. The competitive contracting decision is not an intuitive one. It should and must involve a systematic and comprehensive evaluation of the risks that are faced not only by the agency, but also by all of its stakeholders in the value chain as well. Two types of risk, inherent and acquired, were briefly discussed in the introductory section of this chapter. The remaining sections of this chapter discuss the risk assessment process from identification through mitigation.

4.3.2 Method of identifying risk

Risk identification begins at the start of any competitive contracting project. Many project risks identified at this stage can be quickly counteracted before they can have any significant effect.

Any cost benefit analysis must consider the estimated costs for the management of those risks. Those costs will need to be factored in to any contract administration and monitoring costs (see Section 3.6).

As the competitive contracting project progresses, a more detailed process is undertaken to confirm that all of the risks associated with the project have been identified. Re-examining risk assumptions should occur at any program reviews, major milestone or decision points, and whenever major changes are made to the project's objectives, scope, timing or structure.

There are a number of ways agencies can identify risks, they include, but are not limited to:

- Brainstorming sessions
- Surveys and questionnaires
- Experience/previous history
- Audits or physical inspection of existing service methods and potential service providers
- Flow charts
- Value chain analysis

Whatever method is used, the raw listing of identified risks should be presented to the entire stakeholder community for review and input. Further paring down to reach a final list of identified risks can be achieved by using either multi-voting or an affinity diagram (both are management tools used to organize information usually gathered during a brainstorming activity). There should be agreement between the agency and all stakeholders that the risks associated with the project have been identified and documented in sufficient detail to ensure that they will be clearly understood by all parties.

Here are a number of questions that can be used to facilitate the identification of risks. They are separated by the two types of project risks that may be encountered:

Inherent Risk - Results from the very nature of the project's objectives and scope.

1. **Project objectives**
   a) Is the project large?
   b) How important is the project to the operations and service delivery capability of the agency?
   c) Is the project highly complex?
   d) Does the project have a long time frame?

2. **Scope and approach**
   a) Is the project's scope and approach well-defined?
   b) Do all stakeholders agree that the scope and approach for the project is appropriate?
   c) Does the project have any potential environmental impact?
   d) Does the project require a significant ramp-up, transition period, or an extensive capital investment?

Acquired Risk - Results from selected approaches, methods, techniques, and the relative skill set of those involved in the project.

1. **Business impact**
   a) Will the project force changes in business processes?

b) What other projects will be in progress at the same time?
c) Are changes in the organizational structure of the agency likely to be required?
d) Are other organizational changes likely to occur during the project?

2. **Technology**
   a) Is well-proven technology proposed for the project or is a new and emerging technology to be used?
   b) Does the project include a significant component of custom software development or major enhancements to packaged software?
   c) What is the quality of the existing data and how complex will it be to convert it?
   d) Is the project based on a single technology or does it rely on the integration of multiple technologies?

3. **Project organization**
   a) Are the roles of all project participants clearly defined?
   b) Will the staff assigned to the project be able to devote the required time to it?
   c) To what extent is the project dependent on third parties?
   d) Are the political and personal relationships within the project team and between the project team and the rest of the agency sound?
   e) Will any project participants have conflicts of interest?

4. **Experience, training and support**
   a) Does the project team have experience with the proposed technology?
   b) Does the agency staff have experience with the solution?
   c) Will the solution be well supported both internally and externally?

4.3.3 Sources of risk

The previous section identified methods to identify risk. Of equal value is a discussion of possible sources of risk in competitive contracting. Sources of risk include, but are not limited to:

- Commercial/legal relationships
- Custody of information including the duty to provide and to withhold access
- Financial/market activities
- Intellectual property
- Management activities and controls
- Natural events
- Occupational health and safety issues
- Personnel/human behavior
- Political/legal influences
- Property/assets
- Public/professional/product liability
- Security measures

- Socio-economic factors
- Technology/technical issues
- The activity itself/operational issues
- Business continuity

4.3.4 Categories of risk

Identified risks, regardless of their origin, can be grouped in similar categories. These include financial risks, technical risks, operational risks, legal/contractual risks and organizational risks. Here are a few examples in each category:

Financial risk

- Cost overruns
- Inability to adequately determine the "cost of doing business"
- Inability to identify or document cost savings
- Lack of an appropriate strategy for using or allocating cost savings
- Outlays to settle legal disputes
- Cost of service interruption
- Cost of poor service
- Repair/replacement costs

Technical risk

- Size of project as it impacts staffing considerations, contract duration, and number of government groups involved
- Project structure (risks stemming from)
- New systems required for implementation
- New or additional physical resource requirements
- User perceptions and willingness to participate
- Management commitment

Operational risk

- Inability to benefit from advances in technology or new operating environments
- Failure to achieve contractor "buy-in"
- Inadequate training for state employees
- Inability to identify and document operational efficiency enhancements

Legal/contractual risk

- Inability of a service provider to deliver services in a timely fashion
- Ambiguity in implementing rules and regulations

- Inadequate mechanism to deal with poor or non-performance
- Legal impediments
- Inadequate performance standards
- Financial reporting inadequacies

Organizational risk

- Loss of corporate knowledge by the agency
- Reduction of customer management control
- Resistance to change
- Impact on agency morale
- Deficiency in service delivery during any transition to a new provider

Chapter 4, Section 4

Evaluating and prioritizing risks

4.4.1 Risk rating

Once relevant risks are identified, they must be evaluated and ranked prior to determining how best to either mitigate or manage them. Many organizations use spreadsheets to list and manage all of the relevant facts, categories, and scoring schemes when documenting risk. This phase of risk assessment may benefit from bringing stakeholders and the project staff together in a workshop environment in order to get quicker buy-in as to how each identified risk weighs in comparison to the others.

Determining the likelihood

Determining the likelihood of occurrence may involve objective or subjective considerations.

There are two categories of methods used to determine risk levels, which are discussed below: qualitative and quantitative.

Establishing the impact

Wherever possible the impact of a specific risk occurring should be quantified in terms of cost, time, resources, etc. If it cannot be quantified, then a qualitative scale (such as low to high impact) may be used.

Calculating risk rating

Figure 20 is a matrix that illustrates the relationship between impact and likelihood:

Figure 20

Risk Rating Matrix

Risk Rating Matrix

High Impact	**Medium Risk** Create risk management and mitigation plans	**High Risk** Create detailed and specific plans for management and mitigation or cancellation of project
Low Impact	**Low Risk** Accept or ignore the risk	**Medium Risk** Create risk management and mitigation plans
	Low Likelihood	**High Likelihood**

The team can expand on this and create a scoring and evaluation methodology for each category identified in the previous section (4.3.4). This also provides the team with a place for tracking actions, plans, and decisions.

For instance, consider *Figure 21*:

Category

Risk Management Dashboard

	Risk	Likelihood	Impact	Risk Factor	Action
Organizational Risk	The contractor goes out of business	2	5	10	Develop business continuity plan
	Unable to enforce cancellation for non-performance	3	4	12	Strengthen contract language
	Weak performance standards	4	5		Evaluate composition of team and include more technical expertise in performance based contracting
	Risk Rating = Sum of Risk Factors			42	
	Category Risk Score = Sum of Risk Factors/ Number of Risk Factors			14.00	

Figure 21

Risk Management Dashboard

Key

Likelihood
5 = Certain
4 = Likely
3 = Moderate
2 = Unlikely
1 = Never

Impacts
5 = Disastrous
4 = Major
3 = Moderate
2 = Minor
1 = None

17 - 25 High
9 - 16 Medium
1 - 8 Low

Furthermore, these categories can be summarized and tracked using the format displayed in *Figure 22*. Additionally, different risk categories can be weighted according to importance. This matrix provides an excellent template for project teams to communicate risk levels throughout the competitive contracting process.

4.4.2 Qualitative analysis

Qualitative analysis for scoring of identified risks will involve the subjective judgment and experiences of the team and the larger stakeholder community. Care should be taken to balance the tendency to be dismissive of risks that might be identified via qualitative approaches. Also, the agency needs to consider inherent biases that may be present in those providing their input.

Qualitative risk analysis is the approach that is most readily used in the public sector where issues of accountability and community impact are highly relevant but are gener-

Risk Summary Dashboard by Category

	Risk Rating by Category	Category Risk Score	Total Number of Identified Risks	Trend From Last Report	Risk Level
Financial Risk	5	5	1	=	5
Technical Risk	10	10	1	=	10
Operational Risk	1	1	1	=	1
Schedule Risk	10	10	1	=	3
Legal & Contractual	3	3	1	=	3
Organizational	3	3	1	↑	3
Total	**32**	**5.33**	**6**	↑	**5.33**
	Increasing Risk	Decreasing Risk	No change		Risk Level Legend
Trending Arrow Legend	↑	↓	=		17 - 25 High 9 - 16 Medium 1 - 8 Low

Figure 22

Risk Summary Dashboard

ally impossible or too expensive to quantify. Therefore, decisions are made primarily on the basis of management experience, judgment and intuition. Typical qualitative methods of analyzing risks include, but are not limited to:

- Qualitative mapping
- Brainstorming
- Structured interviews/questionnaires
- Benchmarking
- Networking with professional associations

An example of the qualitative mapping approach is presented in *Figure 23* .

The mapping approach in *Figure 23* can be used to describe the level of risk when using the Qualitive Method. The Qualitive Method identifies the varying levels of risk. These levels are described in *Figure 24* and may be modified to suit individual circumstances.

When qualitative methods are used to evaluate risks, it is important not to overstate consequences. In the case of the mapping approach illustrated in *Figure 23*, the following factors *(Figure 25*) are used to describe consequences. The consequences may be modified to suit individual circumstances.

Qualitative Risk Analysis

Likelihood	Consequences: Neglible	Low	Medium	High	Extreme
Almost certain	Trivial	Major	High	Severe	Severe
Likely	Trivial	Significant	Major	High	Severe
Moderate	Trivial	Moderate	Significant	Major	High
Unlikely	Trivial	Low	Moderate	Significant	Major
Rare	Trivial	Trivial	Low	Moderate	Significant

Risk →

Figure 23 *Qualitative RiskAnalysis Method*

Level of Risk	
Severe	Must be managed via detailed plans reviewed and approved by senior management
High	Requires detailed research and planning
Major	Requires senior management and program level attention
Moderate	Requires management through specific monitoring or response procedures
Low	Can be managed by routine procedure
Trivial	Unlikely to require the specific application of resources, or can be managed through immediate resolution

Figure 24 *Level of Risk*

Consequences	
Extreme	The consequences would threaten the survival of not only the service, but also the organization, probably causing major problems for stakeholders and service delivery capabilities
High	The consequences would threaten the survival of continued effective operation of a service, and require top level administrative intervention
Medium	The consequences would not threaten the service, but would mean that it would be subject to significant review or changes in operating parameters
Low	The consequences would threaten the efficiency or effectiveness of some aspect of the service, but would be dealt with internally
Negligible	Any consequences are dealt with by routine operations

Figure 25 *Risk Consequences*

4.4.3 Quantitative analysis

Data driven decision making is always the preferred method to approach risk analysis. If available, this data can be used to quantify the likelihood of an occurrence and its consequences. Judgment, intuition and non-quantitative experience have typically been found to be less reliable-particularly in the determination of likelihood. Analysis and validation should be performed to test the effects of changes in assumptions and data wherever and whenever possible. Here are some possible techniques and methods that can be used to acquire and analyze quantitative data:

- Statistical and probability models
- Market trends and research
- Actuarial tables
- Network analysis
- Life cycle cost analysis
- Decision trees

4.4.4 Prioritizing risks

The scoring methods illustrated in the previous sections provide simple ways of prioritizing the identified risks. In the next sections we will show how the relative priority of each identified risk can be used by the team to determine an appropriate course of action to treat or eliminate each risk.

Defining a risk as acceptable does not imply that the risk is insignificant. The risk assessment should take into account the degree of control over each risk; the cost impact, benefits, and opportunities presented by the risks; and the importance of the service. In addition, the potential consequences borne by other stakeholders affected by the risk should be considered. It may even be appropriate to inform these stakeholders of such risks.

Reasons for determining a risk to be acceptable include:

- The likelihood and/or consequence of the risk being so low that specific treatment is inappropriate
- The risk being such that there is no treatment available
- The cost of treatment being so excessive compared to the benefit that acceptance is the only option

The risks not considered acceptable are those that should be treated. They should be prioritized for subsequent action as a component of the risk management plan.

Chapter 4, Section 5

Treat the risks

4.5.1 Available options

A combination of options may typically be used in treating risks. Each will be described in detail within this section

- Avoid the risk
- Reduce the risk
- Transfer the risk
- Insure the risk
- Accept the risk

4.5.2 Avoid the risk

Risk avoidance involves the decision not to proceed with the activity that would incur the risk, or choosing an alternative means of action that achieves the same outcome.

Choosing an alternative means of action is dependent on the team's ability to influence the factors around the risk. Recall the distinction between inherent and acquired risks. To avoid an inherent risk, the team would modify the scope and objective of its project. For acquired risks, it may involve bringing in a consultant that has a specific needed skill.

Risk management is not simply an exercise in risk avoidance. There are circumstances in which an agency should retain and manage the risk because it is in the best position to do so.

4.5.3 Reduce the risk

This involves the reduction of the likelihood or the consequences of risk, or both. The likelihood of risk events may be reduced through management controls, organizational arrangements or influence over the external environment. Examples include:

- Revision of procedures
- Quality assurance
- Testing
- Training
- Supervision
- Review
- Documented policy and procedures
- Environmental monitoring

The consequences of risk may be reduced by ensuring that strategies are in place to minimize any adverse consequences. This can typically be accomplished through contingency planning and contract conditions.

In *Figure 21*, there is a column labeled "Action". The items in this column are examples of plans or contingencies to minimize the impact or reduce the probability of occurrence of an identified risk.

4.5.4 Transfer the risk

This involves shifting responsibility for a risk to another party. Risks may be transferred by contract, through administrative process, or by insurance. Risks may be transferred in full or shared by another party. As a general principle, risks should be allocated to the party that is best able to exercise effective control over those risks.

Other issues that should be considered before transferring risk include the need to ensure that:

- The agency only accepts the imposition of external risks, or the limitation of rights it may have against external parties, as a last resort
- Risks are not transferred unfairly to stakeholders who are in a poor position to accept them
- The agency's standard practice is to have a contractor responsible for its negligence or malfeasance

The Office of Financial Management (OFM) has a manual called **Contracts: Transferring and Financing Risk** that describes in detail how to transfer risk when drafting a solicitation or contract (*see http://www.ofm.wa.gov/rmd/contrman/riskcont.doc*).

4.5.5 Insure the risk

This is a common practice and a form of risk transfer. Consideration should be given to alternatives, including self-insurance, at the level of the agency or the service depending on which level has the capacity to best manage the risk. Agencies are advised to consult OFM's Risk Management Division or its own risk management policy regarding the appropriate level of insurance commensurate with the identified risks.

Note: *When evaluating bids, an agency should refer to Section 3.6.4 in the Cost of Government Services Guide in this manual and WAC 236-51-306 (5) for guidance in how to handle insurance and performance bond costs between an EBU and a private bidder.*

4.5.6 Accept the risk

Risks should be accepted in those circumstances where it is either impossible or too costly to avoid, reduce, or transfer the risk. When the agency retains risks, the decision and rationale should be carefully documented. The agency should monitor and develop contingency plans for retained risks.

It should be noted that even when risk treatment is implemented, risk is rarely eliminated entirely. Also, when risk treatment is prioritized, unacceptable risks may remain untreated during the implementation period. Such residual risk should be identified and a rationale provided for the retention of that level of risk.

Regardless of the method selected, the competitive contracting team needs to ensure that risk assumptions, plans, and actions are continuously communicated to agency management and the stakeholder community. The next section describes how the team does that via creations of a risk management plan.

Evaluating risk treatment options

Selection of the most appropriate treatment options usually involves balancing the cost of implementing each option against the benefits derived from it. The cost of treating risks should be commensurate with the benefits obtained. A cost-benefit analysis should be used to determine the total cost impact of the risks identified and the cost of options for managing those risks. In many cases, however, a risk reduction option may not be justifiable on the basis of cost alone. Other factors such as political or social costs/benefits may have to be considered.

Chapter 4, Section 6

Risk management plan

4.6.1 What is a risk management plan?

A risk management plan is an action plan for how the risks that have been identified are going to be managed. There is no set format for a risk management plan as long as it describes what is going to be done, who is going to do it, and when they are going to do it. The format is not important as long as the plan is logical and useable by those persons who are going to use it.

4.6.2 Identify risk indicators/controls

What specific variables will need to be tracked to continuously evaluate risk? In order to illustrate the concept of identifying a risk indicator or control, consider once again the example where the contractor may go out of business (4.4.1). A major risk indicator or control in this example may be financial stability. As part of a management plan the agency can track the contractor's credit rating or other financial ratios. Other risk indicators or controls may include:

- Economic leading indicators
- Stock market
- Employee and customer satisfaction surveys
- Quality data

4.6.3 Plan development process

There are certain elements that a risk management plan should contain. These include:

- A statement of the contract objectives and critical success factors
- An assessment of the adequacy of the objectives or targets
- A structure of how risks will be identified and analyzed
- A list of each category of identified risks showing the likelihood and consequence ratings of each risk
- A prioritized list of risks
- An action plan showing how the risks will be managed
- A statement about how the risks will be reviewed during the project

Most of these elements, focusing on risk identification, risk quantification, risk prioritization, and risk treatment, have already been discussed. Here the focus is on the action plan.

The required actions for any identified risks can be developed into an action plan with an example format as presented below.

XYZ Agency Service

Risks in the Contract Development Phase

Risk Description	Rating	Action(s)Required	Who	When
Failure to obtain necessary approvals	High	Identify approvals required	Project Manager	Prior to plan development.
		Include approvals on project plan	Technical Analyst	Prior to initial review.
		Notify approving parties in advance	Contract Specialist	Initial review.

Risks Prior to Contract Implementation

Risk Description	Rating	Action(s)Required	Who	When
Delay in planned implementation	High	Kick off meeting with awardee to review: • Review transition plan • Requirements • Performance monitoring method.	Project Manager Contract Manager Contract Specialist Awardee	4 weeks prior to contract start

Risks in the Contract Management Phase

Risk Description	Rating	Action(s)Required	Who	When
Late payment of contractor invoices	High	Ensure payment process is consistent with contract obligations	Contract Manager	Upon receipt of first invoice
		Monitor payment performance.	Contract Manager	Ongoing

Developing a risk management plan also involves asking the following questions:

- What is the agency trying to achieve?
- What could go wrong?
- How likely is it to happen, and if it does, how bad will it be?
- Is an exit strategy needed?

- Which risks need to be addressed? and
- What actions need to be taken?

The first question can be answered by listing the objectives and critical success factors for the service being considered for competition. These are the things that the risk management plan should address. Remaining questions could be dealt with in a matrix format similar to that presented below.

Risk Description	Likelihood	Consequence	Risk Rating	Action Who When
What could go wrong?	How likely is it to happen?	How bad would it be? (See 4.4.3)	Which risks need to be addressed? (See 4.4.1)	What actions need to be taken? (See 4.4.5)

Chapter 4, Section 7

Continuous Monitoring, Control, and Review of Risk

4.7.1 Overview

The risk monitoring process ensures that risk management plans are implemented, everyone meets their contractual obligations, and corrective action is taken where appropriate. A frequent breakdown that occurs results from agencies failing to create policy that requires regular review, corrective action, and accountability to manage the contractual relationship.

Several key questions need to be asked when considering the monitoring and review of risks:

- What process will be used to ensure that the actions in the action plan are implemented and new risks are addressed?
- What are the agency's obligations under the contract and how is meeting them being assured?
- What are the service provider's obligations under the contract and how is meeting them being assured?
- Do the performance indicators that have been developed address the key success elements?
- Are the assumptions, including those made in relation to technology and resources, still valid?
- Are the chosen risk treatments effective in minimizing risks?
- Is adequate management and accounting controls in place?
- Do the chosen risk treatments comply with legal requirements and organizational policies, including access and accountability?
- Are risks being borne unfairly by stakeholders and/or service providers?

There are three key things that should be done during the risk monitoring phase:

- Review the risk management plan
- Monitor contract performance
- Monitor contractual obligations

4.7.2 Methods of review

There are a number of ways agencies may provide for continuous review and scrutiny over risk management plans (see Chapter 7). These methods include, but are of course not limited to:

- **Internal auditing** - Agencies should insist on this as a requirement of key private providers (financial, quality, and business systems)
- **Operational reviews** - Agency senior management and key stakeholders review not only the operational results but also the current risk landscape
- **Customer & Employee Surveys** - The frequency and timing should be such as to provide early warning of problems
- **External Audit** - A third-party audit conducted by a risk management consultant or evaluator
- **IT Portfolio Management** - A primary tool to support IT decision-making

Chapter 4, Section 8

Additional resources

1. Project Risk Management Guideline; New South Wales Government - *http://www.oict.nsw.gov.au/content/2.3.24-Project-RM.asp*
2. Washington State Department of Information Services Board IT Investment Standards (Appendix A - Severity & Risk Level Criteria and Oversight) *http://dis.wa.gov/portfolio/101S.htm#appendixA*
3. Washington State Office of Financial Management; Operating Budget Instructions, Part 1; Guidelines for Strategic Plans and Performance Measures 2005-07 Biennium - *http://www.ofm.wa.gov/budget/instructions/05-07budinstpart1.pdf*
4. Washington State Office of Financial Management; Contracts: Transferring and Financing Risk - *http://www.ofm.wa.gov/rmd/contrman/riskcont.doc*
5. Department of Veteran Affairs; Information Technology Information Services Guide, Appendix I - *http://www.va.gov/oirm/ITplanning/AppendixH.pdf*
6. Washington State Office of Financial Management; Client Service Contracting Guide, Appendix A Risk Assessment Tools from State Agencies - *http://www.ofm.wa.gov/contracts/csg/appendixa.pdf*